DOW THEORY LETTERS INC.

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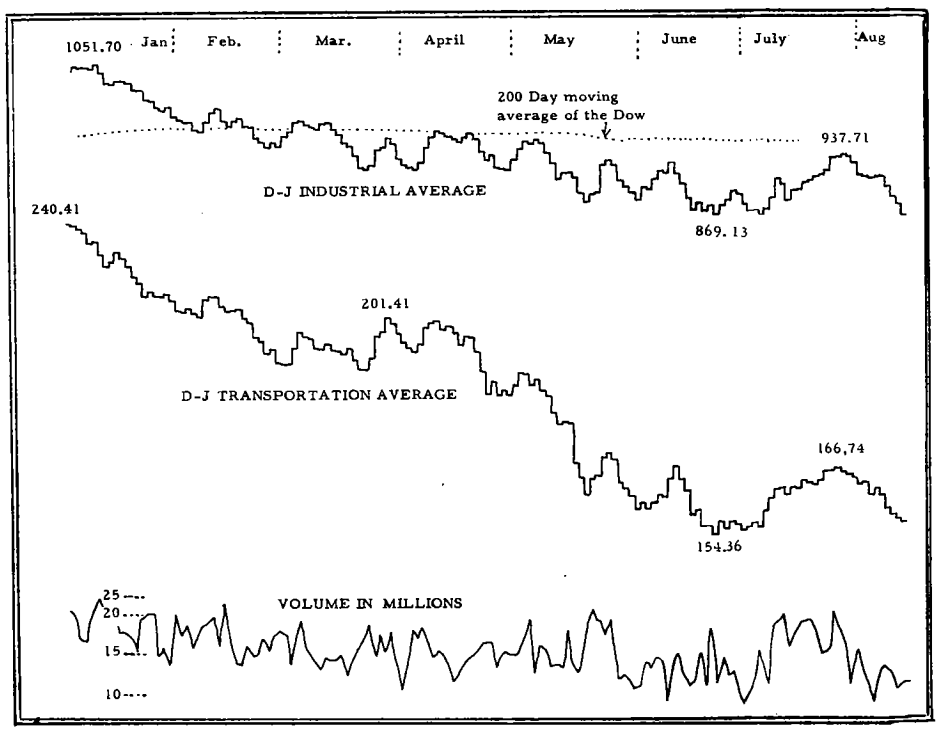
Aug. 3, DJIA 908.87; PTI 688; A-D ratio -14.10
Aug. 10, DJIA 892.38; PTI 669; A-D ratio -15.02

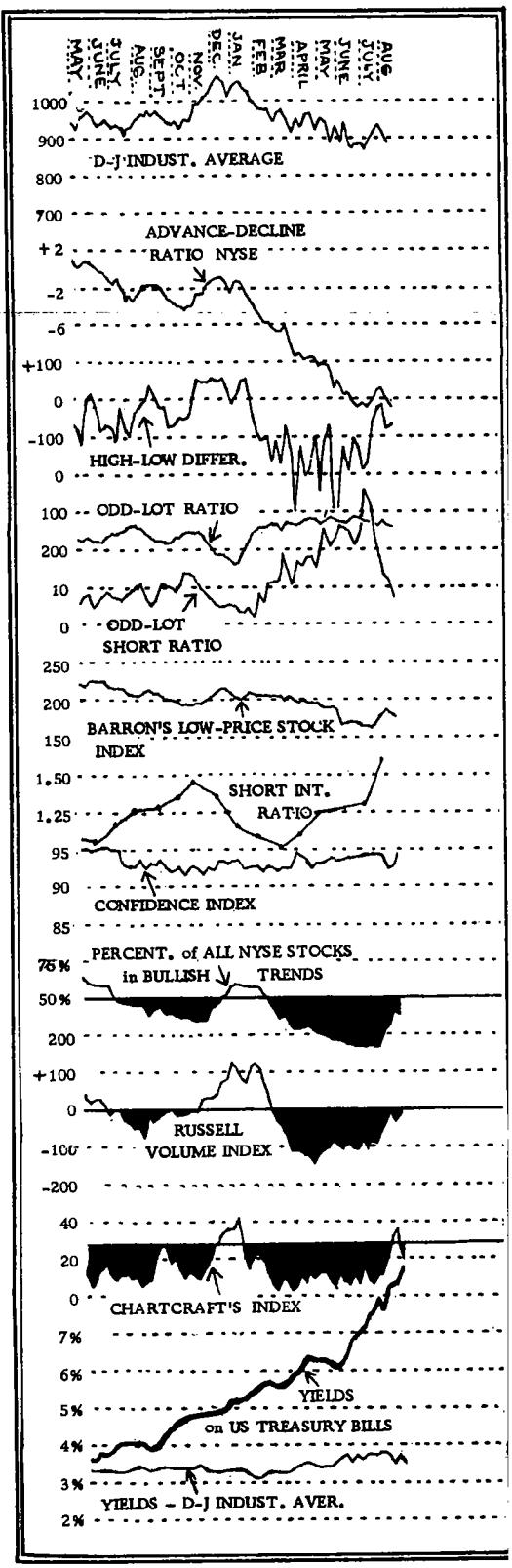
QUOTE OF THE WEEK: "The US Government is now all arms and legs; it has no head. It is running and swinging more excitedly than ever, but no longer planning at all, let alone listening." Eliot Janeway, Janeway Service, August 8.

THE PICTURE: On August 9 the long-awaited rally of the dollar commenced. The rally may have started for a number of different reasons. It may have started because the selling was overdone and the dollar was drastically undervalued in terms of other currencies (even the shorts had overstayed their positions). Or the dollar rally could have been set off as a result of sky-rocketing interest rates in the US, interest rates which were drawing money not only "from the moon" but from the stars as well. On August 10 the prime rate at leading banks was boosted from a record 9% to a new record 9.25%. On the same day I was amazed as a leading West Coast bank offered me 11.3% on a C/D of $100 thousand for 150 days! In the face of these fantastic rates, it becomes a bit rough to do business (and it becomes very rough to sit with anything; gold bullion, gold shares, bonds or common stock, all of which dutifully declined).

On Wall Street they used to say that "The market will do what it has to — to drive the greatest number of people crazy!" And the recent action has been no exception. For months stockholders have been telling themselves that "as soon as the dollar rallies, the stock market will take heart and rally too." But ironically, the sky-high interest rate background, which obviously strengthened the dollar, was hardly the kind of thing which helps stocks — so stocks headed down in the face of the stronger dollar.

It seems that the great paradox has arrived. High interest rates will help the dollar and perhaps squeeze the inflationary forces, but high interest rates also squeeze common stocks. Conversely, if interest rates decline the dollar will most likely weaken, gold bullion will rise along with gold shares, and common stocks may enter another bear market rally. Make no mistake about it, lurking behind the interest rate wall



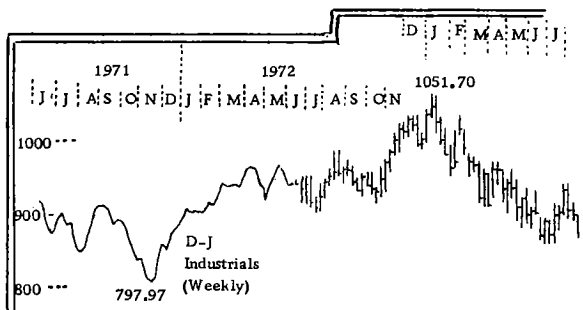


 and the desperation of Phase IV is the straining power of the worst inflation this country has seen in a century.

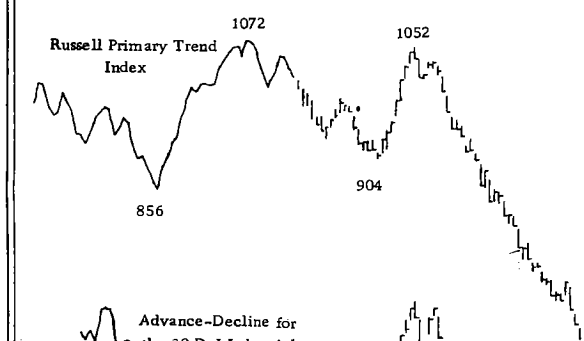
So it appears that the manipulations and mindless "fine tuning" of countless US "administrators" and politicians has reaped its fruit. We are at the point where if one button is pushed, another is set off, and if the new alarm button is silenced, three others start ringing. Perhaps the incredible spectacle of a President who tapes all his conversations and then withholds the tapes, a Vice President who may be up for indictment (tax evasion, bribery, extortion), galloping inflation, an econcomy besieged by controls, perhaps they all merely reflect our times. As this is written it seems as if the very fabric of America is being ripped apart. All this it is Wall Street's job to appraise and discount.

I am including my chart of the Dow and three important indicators which are periodically monitored in these reports. Weekly figures (Friday's close) for two of these (PTI, A-D ratio) are listed in each report on page 1, and I have urged subscribers to chart these two indices along with the Dow. It has been most interesting to me to note that the Primary Trend Index (PTI) is the one which had led this market down. On August 1, the PTI broke below its previous low which was recorded on July 6 (see Letter 570, page 2). It should be remembered that I named this index the "Primary Trend Index" because each day it takes into account the movements of eight critical technical measurements, namely, the D-J Industrial, Transport and Utility Averages, the broad S-P 500 Stock Average, the D-J 40 Bond Average, the A-D ratio, the highs and lows, and the most-active stocks.

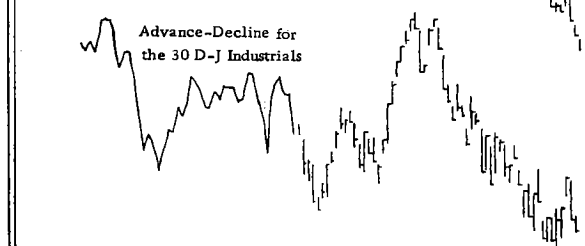
I concluded that the cumulative movement of these eight indicators could provide us with an index which would gauge the primary trend of the market. During a primary bull market the trend of the PTI would be up, with peaks and bottoms tending to be above preceding peaks and bottoms. In a primary bear market, the reverse would hold true. Since a primary movement usually sweeps everything before it, it tends to work like the water level in a bath tub. During a bull market the waterline of the bath tub rises, despite any and all temporary splashes and ripples. During a bear market, the waterline acts as if the drain has been pulled. It is this bath tub waterline-effect which the PTI measures.

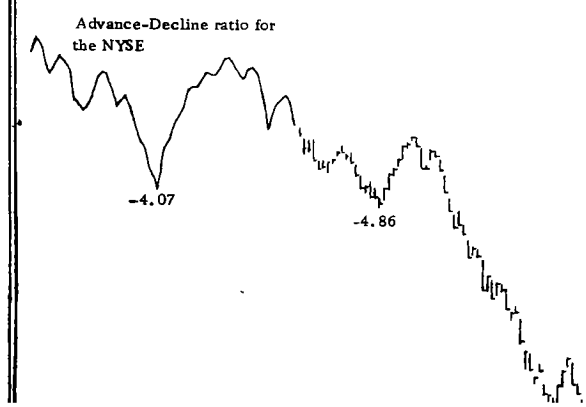


It is therefore hardly an accident that the PTI, my broadest gauge of market action, has been the most vicious performer on the downside during this bear market. The PTI was the first indicator to break to new lows, and it was the indicator which performed most feebly on the rallies. Actually, as I study the dramatic and continuous crash of the PTI since its December, 1972, peak of 1052, I find myself wondering how much longer the Dow Industrials can manage to hold out against the PTI. The vacuum created by the Dow-PTI divergence grows greater and greater. If the PTI continues to plunge (as it has been doing), I feel it is only a matter of time until the Dow heads lower with a force which will literally astound Wall Street.



To review last week's action, the PTI as noted above broke to a bear market low on August 1. On August 13, eight trading days later, a "technical crunch" confirmed the previous PTI prediction. On that day (1) the A-D ratio (see chart) smashed to its lowest level since the 1940's, (2) the A-D index for the 30 Dow Industrials broke to a new bear market low, (3) the cumulative most-active stock index broke to a new low (see Letter 567), (4) the D-J Utility Average violated its 1970 low (see next section). After the close of the market the Federal Reserve Board did its bit by raising the discount rate ½% to 7.5%. Since the discount rate is classically about ½% below the T-Bill rate (which is now 8.8%), all the Fed did was adjust their rate upward towards reality. But the effect was hardly calculated to produce bullishness in the money market or on Wall Street (since it shows the Fed's intentions, which is "super-squeeze"). As this is written, the money market is reeling somewhere between panic and numbness.





UTILITIES: Next I come to a phenomenon which I consider to be of utmost importance. It is the Utility break of August 13. In the last Letter I drew attention to the horrendous Utility decline, and I noted that the D-J Utility Average was heading for a test of the 1970 bear market low of 95.86. I also included (Chart of the Month) a graph of the Utilities which I interpreted under

the Elliot Wave Principle. My conclusion was that the Utility Average had completed wave A (1965 to 1970) of a major Elliot bear market, it had also probably completed an upward correction (wave B) of the Elliot bear market, a wave from the 1970 low to the 1972 peak. I felt that the Utility Average was now embarking on major downward wave C.

Under Elliot, the C leg constitutes the final wave of a bear market, but the C wave is often the longest and most destructive. I feel that the penetration of the 1970 low of 95.86 confirms the thesis that wave C is now in effect. This is obviously long-term bearish under Elliot Principles.

From another standpoint, it should be noted that the break under 95.86 takes Utilities to their lowest level since 1960! Thus it may be said that the D-J Utility Average is the first of the D-J Averages to break down "completely," and the question is, "What does this mean?" The Utility Average led the other Averages up all during the primary bull market of 1949-1966. My feeling is that this same Utility Average is now leading the market down, and it will only be a matter of time before the other Averages follow to new bear market lows.

To put it another way, it is hardly probably that one of the Dow Averages would break to a 13-year low if we were actually in a bull market. I therefore take the new Utility low as added proof of my thesis that we are now in a major or primary bear market, and that we have been in a primary bear market ever since February, 1966. Time is running out on the bulls, and those who overstay this market will ultimately be smashed by the bear. The Utilities have given us a valuable "signal." Those who understand the meaning of the primary trend will not be tempted to ignore the message of this investment-grade Average.

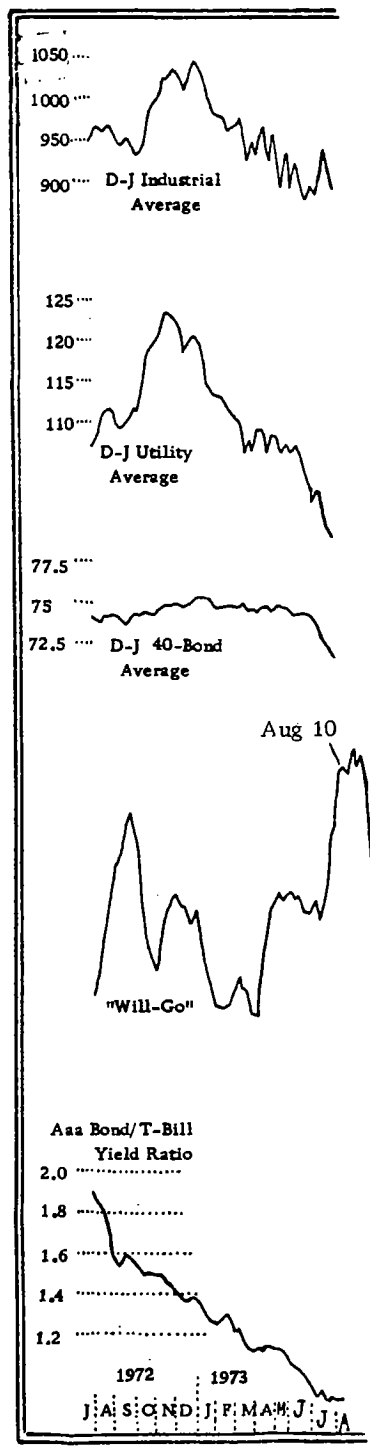
MONEY: The oft-updated monetary chart shown here has never assumed greater importance. Here we see the Utilities and D-J 40-Bond Averages plunging to lower levels. As noted many times, a declining trend in both of these indices constitutes a bearish background for the market. The week ending August 10 was the 4th successive week of decline for the 40-Bond, the 7th successive for the D-J Utilities.

Will Go, our crystal ball friend, plunged again last week, and this index is now saying that the decline will last until at least the third week of October (remember, Will Go is plotted 10 weeks ahead). It is probable, as I stated in the last report, that money conditions are now so ghastly that the stock market jumped the gun on Will Go's prediction of trouble to start around the middle to the end of August. Remember, Will Go predicts direction, not extent, of a move.

Finally, the ratio of Bill yields to Aaa Corporate bond yields dropped to a new low of .89 this week. On those rare instances wherein short-term yields are above long-term yields (as now), this ratio reads under 1.00 (as it is now doing). The Holt Advisory points out that only five times in history has this warped short term-long term relationship existed, 1920-21, 1928-29, late 1959, 1966, and 1969-70. This is the sixth. Each of these periods was accompanied by a good drop in stock prices. To the credit of the Bill/Bond ratio, the current money crunch was forecast well in advance (check your April reports). So the conclusion is that it's costing alot of green paper to borrow green paper these days — with no end in sight judging from my indices.

THE GATHERING STORM: "Everyone wants to get rid of gold," or so runs the fantasy-song of leading US politicians. But as of now, it must be admitted that the song is just a propaganda-spiel, and it has to do with "impending gold sales," a world jettisoning of gold as international money, and a whole string of endless hopes, wishes, threats and predictions regarding "next month's" or "next year's" meeting of the IMF or some other "group" or "agency."

In his last report, Donald Storey (Bank Credit Analyst) has a few timeless words to say about money. "Governments do not have the capacity to demonetize arbitrarily a particular asset that happens to have the 'money' qualities attached to it. Government can legislate what is to be legal tender, but they cannot legislate what is to be money ...Money has two basic qualities — store of value and medium of exchange. Lack of one destroys



the other. These qualities are imputed by the public to particular assets and are based on trust and confidence. Governments, pathetically thrashing around trying to stop the symptoms of financial trouble, are in no position to dictate what is and what is not money. That is the prerogative of the people, and they have always attributed the money quality to gold in times of great difficulty. Gold can be bought and sold and exchanged for goods and services anywhere in the world in any size and with anonymity, no questions asked. No other asset can make a similar statement."

MONETARY RESERVES OF PRINCIPAL NATIONS

	TOTAL RESERVES	MONEY SUPPLY	GOLD @ $42.22 PER OUNCE	GOLD RESERVES AS % OF MONEY SUPPLY
	(MILLIONS OF $ U.S.)			
U. S.	$14,337	$263,000	$11,651	4.4 %
England	6,118	32,701	------	----
France	11,461	65,835	4,260	6.4 %
Germany	31,988	47,743	4,964	10.4 %
Italy	6,351	65,050	3,483	5.4 %
Canada	6,093	21,680	927	4.3 %
Japan	16,835	123,034	890	0.7 %
Switzerland	7,458	17,469	3,513	20.1 %
South Africa	1,717	4,102	800	19.5 %

What we are seeing now is a great paradox. On the one hand the US is attempting to "propagandize" gold out of the monetary system. (The insanity of the US position can be seen when we realize that the US is insisting on an unrealistically low "official price" of $42.22 while at the same time it is hanging onto its remaining $10 billion stock of gold like grim death).

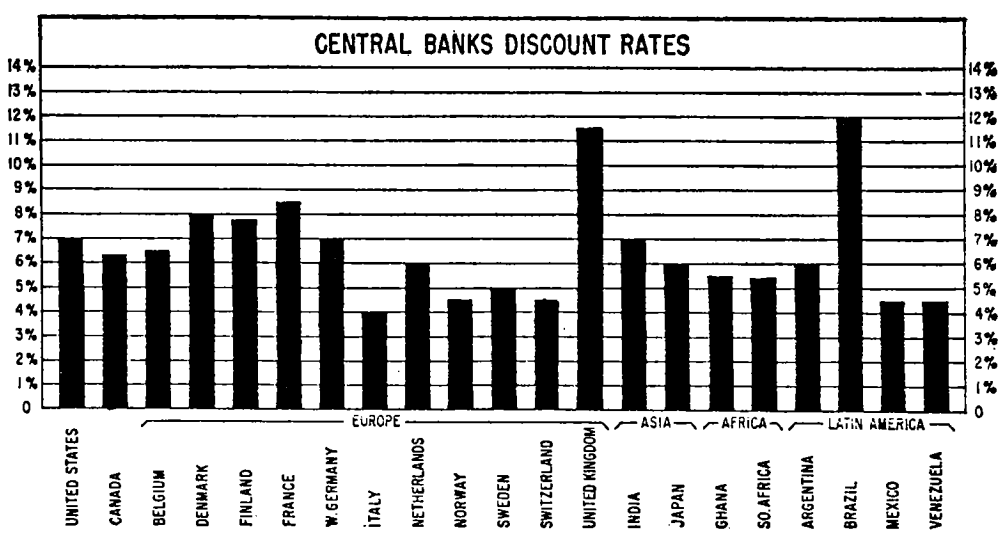
The veiled threats to knock down the price of gold by selling $1 billion or so of gold on the free market may serve to scare Americans out of their gold shares, but this is how Reuters (July 23) treats that rumor. The gold sales "...are supposed to be made by Washington according to the Bundesbank; by the IMF and by Moscow according to Washington, which most significantly disclaims that any are to be made by the US, unilaterally; and by no Western central bank according to the skeptical Swiss one."

The fact is that no central banker would sell any amount of gold, and the majority of central banks would be only too happy to buy gold for unwanted dollars (after all, what would they sell their gold for — more dollars, hamburger, soy beans?).

I include above a tabulation (by Powell Monetary Analyst, 63 Wall St., NYC 10005) which shows (1) the total reserves of various nations (which usually consist of gold and dollars), (2) the total money supply of these nations, (3) the amount of gold (at the $42.22 price), and (4) the percentage of each nation's money supply represented by "real reserves" or gold. As you study these tabulations, do you think that any of these nations stand ready to sell any part of their gold reserves? If you do, try writing to their respective Treasurers and ask them about it (and you might also ask them how their present gold reserves compare to their gold reserves of a few years ago).

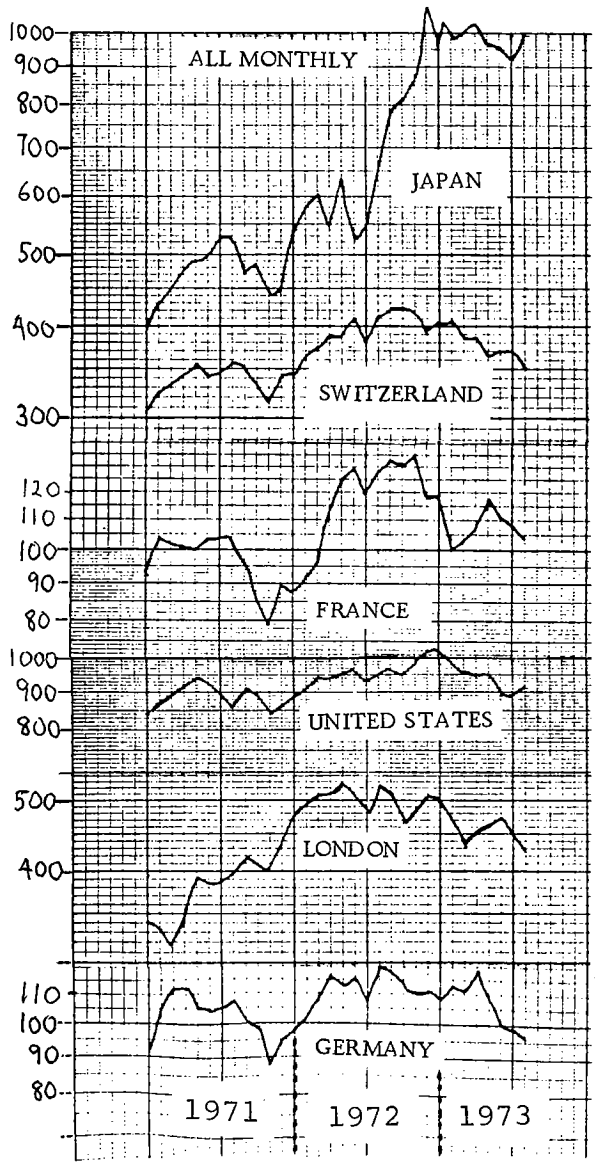
The fact is that paper currencies throughout the world have been inflating at enormous rates, and that except for Switzerland and South Africa, most of the world's central banks stand ready to turn in vast amounts of dollars for gold in an effort to boost the quality of their reserves. Furthermore, little is actually known regarding who is buying gold now or in what quantities. It may come as a shock to most readers but London (which gets the publicity) is not the big gold market. As Harry Schultz states in his late-July report, "Switzerland gets 90% of the volume" in gold, not London. Switzerland is notably secretive about volume of gold sales.

Meanwhile, an ominous battle is going on around the world, perhaps best dramatized when (on July 27) Britain raised its bank rate to an incredible 11.5%. As you can see on the accompanying chart, the bank rates of the nations of the world are now rising like fingers pointing skyward, and I wonder if it is prophetic that Britain's new rate is matched only by the rate of Brazil. What these whopping world-wide rates mean to me is that the nation's of this planet are now faced with the choice of continued roaring inflation or business contraction and recession (I stay away from that word, depression).



My feeling is that it will be a difficult and bloody struggle, but when confronted with a contraction in business, the various countries will give way to more inflation rather than strangle business. Thus, the politicians will do what they have always done, pick the route which "seems" to avoid the pain. And when the citizens of the various nations fully grasp the picture, they will seek to protect themselves by (1) buying gold bullion, gold shares, gold coins, and (2) spending or getting rid of their paper currencies. This should have the effect of booming gold shares and gold, intensifying inflation, and setting the stage for a world-wide collapse.

There is one very important phenomenon which is now taking place, and it is doing so with little or no publicity. This is the decline of leading stock averages across the globe. I am reproducing my own chart of the Dow together with stock averages of five leading economic powers. In each case, it appears that the top has been formed and that the stocks of these nations are heading down. All averages are charted to the same ratio scale so that percentage on movements can be properly compared.

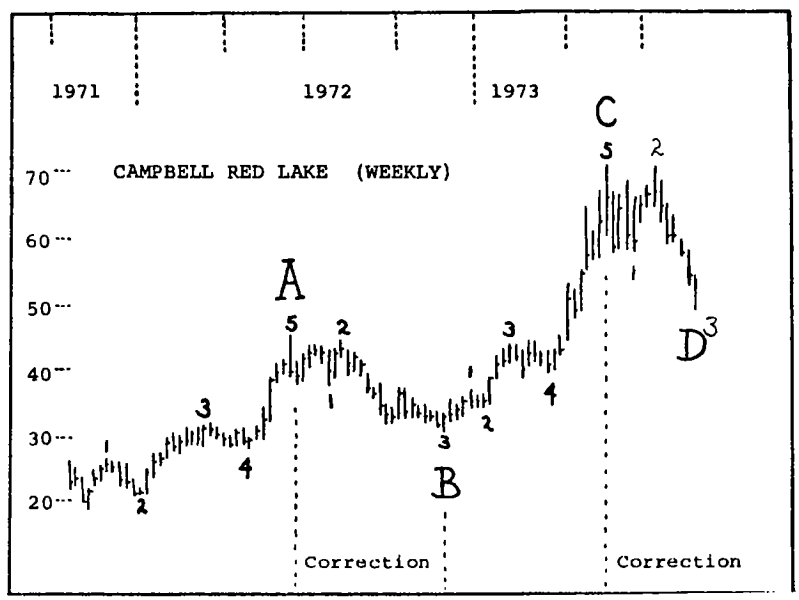


What is the reason for this international decline? Could stocks be discounting the effects of the current interest squeeze and the potential exhaustion of the world economic boom? Has the world finally seen that inflation is a destroyer, and is it facing up to the choice of destruction via inflation — or massive squeeze via high interest rates and deflation? The answer to the question could well be ..."Yes."

GOLD: Under the pressure of record high interest rates, gold bullion has been hit by (1) the high cost of carrying gold bullion, and (2) the attractiveness of debt instruments, particularly short-term debt, of 10% and over.

I have been asked to update my Elliot studies of gold shares, and for this I have picked a very representative issue, Campbell Red Lake (see chart). My belief is that CRK (as are the other golds) is in a major bull market, which should take the form of an A-B-C-D-E pattern with the B and D waves being the corrective waves.

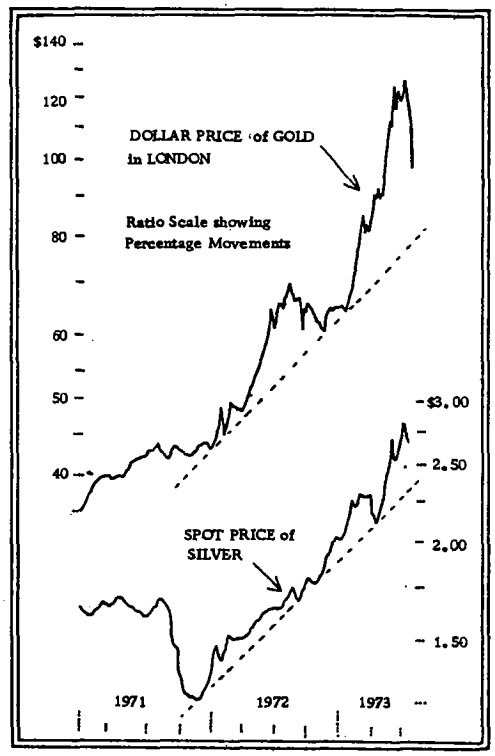
As seen on the chart, wave A ended in mid-1972, with corrective wave B terminating in late-1972. The booming move of 1972-73 assumed the form of a 5-wave rise, the 5 waves constituting major up-wave C. Currently, we are deep in corrective wave D, and this wave should terminate with (1) a discounting of the peak in interest rates (in other words, it will try to jump the gun on the interest rate peak), (2) a realization that inflation is continuing and that any cessation of record interest rates will simply intensify the continuing inflation, and (3) a business slowdown and a discounting of general easing of controls prior to new attempts to "re-flate" world economies (already Europe and Japan are experiencing some acute contractions in various areas of business). As an added note, as Phase IV starts (amid record interest rates) big companies are lining up to petition for increased prices. Thus, the purchasing power of currencies continues to erode.



Note on the chart that the current corrective wave D has now traced out a 1-2-3 downward zig-zag, and this suggests that we could be nearing the end of this major correction in the golds. The high churning action of gold shares on August 14 suggested to me that some accumulation of gold shares was taking place, and on August 15 the gold shares began to turn firm for the first time in weeks.

According to my Elliot studies, the next movement in golds should be consistent with an "E wave" in

Campbell. This should be the major upward leg, and it should take the form of a 1-2-3-4-5 series of rising zig-zags. The fifth or final Elliot wave is often long, exponential and highly speculative. If this is what comes to pass, we should see a massive move up in gold shares and a great deal of turmoil in the world monetary picture.



A good many gold shares are now selling on a most attractive earnings and yield basis, and for those who do not own golds or want to add to their gold portfolios I suggest the following: ASA Ltd. (the NYSE listed holding company which holds mainly S. African gold shares); also the ADR's in West Driefontein, Kloof, Vaal Reefs, President Brand, President Steyn, East Driefontein, Blyvoors, Welkom, Elsburg.

On August 15 (see chart) gold bullion hit $94 at the second London fixing, and so the correction of the giant 1972-73 bullion rise goes on. I suspect that the correction is nearing its end, however, and it should be remembered that (1) the gold shares will probably turn up before world interest rates turn down, and (2) gold bullion is very explosive and could be half-way back to its $127 high before anyone knows what has happened. The chart pictured here is drawn to ratio scale, which means that it shows percentage of rally and decline. Silver, as seen on the chart, is also holding above a long-term trendline, and in terms of percentage of rise since the 1971 low, silver has not really lagged too far behind gold.

LATE NOTES: On August 14 the D-J Industrials closed at 870.71, Transports at 156.41. Thus the two Averages have come down to within a few points of their 1973 lows which were Industrials 869.13, Transports 154.36. Joint penetration of those lows will constitute reconfirmation of the major downtrend now in effect. Furthermore, new lows in the Averages would confirm what I see in the bearish penetrations of the various indicators as discussed earlier in this report. Or to put it another way, the Dow Industrials have been acting (via their strength) like a brake for the market on the downside. If the brake is released, watch out.

Despite the early rally of August 15, bellwether GM broke below its 63 low to skid to a new low for the year. I consider this to be bearish action and ominous in its implications. I might add that my charts show breakdowns in many of the consumer-oriented Dow Industrials such as American Brands, American Can, Woolworth, Chrysler, GM. At 96 Proctor joins the top-out parade. Only 33% of the 30 Dow Industrials are now in bullish trends.

Some of the major growth stocks are now showing signs of distribution with Avon Products now definitely breaking down from a 3-year trend of rising relative strength. IBM, although few realize it, is currently below its 1968 peak of five years ago!

SURVIVE WITH ME: I have just planted a vegetable garden as part of my "gold and vegetables" plan to survive the bear market. Actually, I have found that I get along beautifully without meat (I gave up on it about a year ago), and I substitute cheese. Reason, I feel "lighter" without meat and somehow healthier, although I do eat an occasional hamburger, just to keep California's economy humming (everyone out here either sells hamburgers, or constructs hamburger stands or is in the business of financing hamburger franchises). Remember, elephants have the strength of an elephant and they never touch a bit of meat, so don't panic if you have to change your life-style and hit the healthy vegetable path.

Second hint: cut your milk bills by two-thirds by drinking "Sanalac," or dried skim. You simply mix it with a quart of water, but it must be served cold (chill overnight in the refrigerator). You can't tell it from regular skim. Get out of the habit of drinking whole milk, you just take in alot of butter fat which you do not need. Sanalac costs 15¢ a quart to make, but no other brand has the excellent taste of Sanalac.

The Calif. Dept. of Fish & Game has just put out a bulletin on "Catfish Recipes" showing 21 ways of preparing "delicious catfish," and they say that the cats are a perfect way to beat high meat costs. I agree. Calif. has just planted half a million yearling catfish in its lakes, so why fight that?

Final note: some of the frozen soy imitation meats are fantastic (and they contain no cholesterol). Try Morningstar Farm's "Breakfast Patties," which look like sausage patties, and I'll swear they taste exactly like them too — but they're much cheaper.

CORRECTION: Letter 571, page 5, last paragraph, please read SDR's for ADR's. . .Apologies.